

CLAIBORNE INDUSTRIES LIMITED

Annual Report 1977



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Claiborne Industries Limited

February 15, 1978

TO THE SHAREHOLDERS

Your Company incurred a loss of \$282,548. in the year ended September 30, 1977 after providing for the following major expenses:

Provision for loss in respect of a major account receivable which has been in doubt since 1975 amounting to \$225,000.

Expenses relating to the Special Shareholders Meeting and the investigation made into the advances to former directors and to shareholders and companies related to them in the amount of approximately \$65,000.

Interest expense of approximately \$292,000. was incurred largely because the Company has not off-set interest income in respect of the said advances.

Rocamora Bros. Canada which is the only operating division of the Company has had a successful year with an increase in sales of 11 per cent. The favourable trend has continued in the most recent quarter ending December 31, 1977 in which the profits before income taxes amounted to approximately \$65,000. after providing for net interest expenses of about \$58,000. Projected sales for the balance of the fiscal year look encouraging and should result in a sales increase over the past year together with a profit and positive cash flow after all expenses. Because of the continuing slow down in the construction industry I am unable to make a more firm projection of the year's result.

As reported to you in a letter dated 17th January 1978 proceedings have been instituted against the Provincial Bank of Canada and two former officers of the Unity Bank as well as against James H. Black, J. Edward Whiteside, Barry Hill and a group of companies controlled by one or other of them for the return of the \$1,106,252. advanced to former directors and shareholders and companies related to them and for substantial damages.

I ask that you read very carefully the accompanying financial statements and notes in order that you may more fully understand the Company's financial position and its claims in the various law suits mentioned in the notes to the financial statements.

In conclusion I would like to express on behalf of all of the shareholders our sincere appreciation and thanks to the management and employees of the Company who have carried on the business of the wholesale plumbing and heating division in a most efficient and successful manner. The problems and frustrations that they have experienced resulting from the financial concerns relating to the advances referred to and the attendant publicity have been most upsetting to them. They have as well experienced the inevitable problems resulting from the complete change made in mid year in the officers and directors of the Company. They are to be congratulated for their continuing support throughout and for their efforts in assuring that the wholesale plumbing and heating business continued to hold a firm and favourable and respected position in the industry and that sales have continued to increase.

Yours very truly,

John M. Boyd
President

Claiborne Industries Limited

AUDITORS' REPORT

To the Shareholders of
Claiborne Industries Limited

We have examined the consolidated balance sheet of Claiborne Industries Limited as at September 30, 1977 and the consolidated statements of income, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances, except as explained in the following paragraph.

Certain of the companies' accounts and records are in the possession of the Royal Canadian Mounted Police under a search warrant dated January 24, 1977. It was not practicable for us to perform such tests and other procedures as we considered necessary in order to gain a sufficient degree of assurance that, for the period from October 1, 1976 to January 31, 1977, the companies' system of internal control operated in a manner consistent with that of the balance of the year nor that it operated effectively throughout that period.

In our opinion, except for the effect of such adjustments and further disclosures, if any, which might have been required had we been able to carry out the audit procedures referred to in the preceding paragraph, and subject to:

- (i) the ultimate realization of the amounts advanced to former shareholders and companies related to them of \$1,106,252 as described in note 3 to the financial statements; and
- (ii) the effect, if any, upon the resolution of the matters referred to in notes 7 and 11;

these consolidated financial statements present fairly the financial position of the company as at September 30, 1977 and the results of its operation and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the elimination of interest as described in note 3, on a basis consistent with that of the preceding year.

Toronto, Canada
February 2, 1978

THORNE RIDDELL & CO.
Chartered Accountants

Claiborne Industries Limited

(Incorporated under The Companies Act of Alberta)

CONSOLIDATED BALANCE SHEET AS AT SEPTEMBER 30, 1977

ASSETS

	1977	1976 (Restated —note 3)
CURRENT ASSETS		
Cash	\$ 7,329	\$ 5,101
Accounts receivable, net of allowance for doubtful accounts of \$684,172; \$433,909 in 1976 (note 2)	1,380,052	1,691,188
Inventories, at the lower of cost and net realizable value	1,608,489	1,706,355
Prepaid expenses and deposits	25,576	7,097
	<u>3,021,446</u>	<u>3,409,741</u>
ADVANCES, with no fixed terms of repayment (note 3)		
Former shareholders and companies related to them	1,106,252	1,601,251
Other, Finch and Weston Road property	129,583	
	<u>1,235,835</u>	<u>1,601,251</u>
FIXED ASSETS (note 4)	447,451	472,146
OTHER ASSETS (note 5)	3,457	15,507
	<u>\$4,708,189</u>	<u>\$5,498,645</u>

LIABILITIES

CURRENT LIABILITIES		
Bank indebtedness (note 6)	\$1,111,618	\$1,490,204
Accounts payable and accrued liabilities	1,128,206	1,067,764
Income taxes payable		16,863
Current portion of long term debt	12,310	14,527
	<u>2,252,134</u>	<u>2,589,358</u>
LONG TERM DEBT (note 7)	1,327,670	1,498,354

SHAREHOLDERS' EQUITY

CAPITAL STOCK (note 8)		
Authorized		
4,000,000 Class "A" non-voting, fully participating shares of no par value		
2,000,000 Common shares of no par value		
Issued		
1,255,421 Common shares	3,655,814	3,655,814
CONTRIBUTED SURPLUS	24,040	24,040
DEFICIT	(2,551,469)	(2,268,921)
	<u>1,128,385</u>	<u>1,410,933</u>
	<u>\$4,708,189</u>	<u>\$5,498,645</u>

Legal proceedings (notes 3 and 11)

Approved by the Board
J. M. Boyd, Director
J. G. Roberts, Director

Claiborne Industries Limited
CONSOLIDATED STATEMENT OF INCOME
YEAR ENDED SEPTEMBER 30, 1977

	1977	1976 (Restated — note 3)
Sales	\$8,234,410	\$7,447,637
Cost of sales	<u>6,326,287</u>	<u>5,713,750</u>
Gross profit	<u>1,908,123</u>	<u>1,733,887</u>
Expenses		
Selling, administrative and general	1,620,793	1,300,868
Provision for doubtful accounts (note 2)	256,102	97,871
Interest on long term debt	147,372	153,560
Other interest	144,394	156,550
Depreciation	<u>33,116</u>	<u>35,161</u>
	<u>2,201,777</u>	<u>1,744,010</u>
Loss before income taxes and extraordinary items	<u>293,654</u>	<u>10,123</u>
Income taxes		62,698
Loss before extraordinary items	<u>293,654</u>	<u>72,821</u>
Extraordinary items		
Gain (loss) on retirement of debentures	11,106	(15,000)
Reduction of income taxes resulting from application of prior periods' losses ...		47,000
Gain on sale of investments		1,521
Provision for loss on investment in Creative Patents & Products Limited		(212,000)
Recovery of advances to Jamaican subsidiary, previously written off		<u>17,248</u>
	<u>11,106</u>	<u>(161,231)</u>
LOSS FOR THE YEAR	<u>\$ 282,548</u>	<u>\$ 234,052</u>
LOSS PER SHARE		
Loss before extraordinary items23c	.06c
Loss for the year23c	.19c

CONSOLIDATED STATEMENT OF DEFICIT
YEAR ENDED SEPTEMBER 30, 1977

	1977	1976 (Restated — note 3)
DEFICIT AT BEGINNING OF YEAR		
As previously reported	\$2,030,185	\$2,007,362
Elimination of interest accrued on Advances, net of applicable income taxes (note 3)	<u>238,736</u>	<u>27,507</u>
As restated	2,268,921	2,034,869
Loss for the year	282,548	234,052
DEFICIT AT END OF YEAR	<u>\$2,551,469</u>	<u>\$2,268,921</u>

Claiborne Industries Limited

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

YEAR ENDED SEPTEMBER 30, 1977

	1977	1976 (Restated — note 3)
WORKING CAPITAL DERIVED FROM		
Operations		\$ 9,493
Advances, realization of security (note 3)	\$495,000	
Issue of long term debt		
Mortgages		150,000
Debentures, net of amounts exchanged		188,750
Other		10,412
Proceeds on the sale of investments, net		415,050
Recovery of advances to Jamaican subsidiary		17,248
	<u>495,000</u>	<u>790,953</u>
WORKING CAPITAL APPLIED TO		
Operations	259,489	
Reduction of long term debt	24,684	16,504
Advances (note 3)		
Finch and Weston Road property	129,583	
Former shareholders and companies related to them		665,039
Acquisition of subsidiary, including its working capital deficiency of \$123,061 (note 10)	123,894	
Investment in Creative Patents & Products Limited, net		212,000
Purchase of fixed assets, net	8,421	13,681
Other assets		10,000
	<u>546,071</u>	<u>917,224</u>
DECREASE IN WORKING CAPITAL	<u>51,071</u>	<u>126,271</u>
WORKING CAPITAL AT BEGINNING OF YEAR		
As previously reported	926,385	974,161
Elimination of interest accrued on Advances, net of applicable income taxes (note 3)	106,002	27,507
As restated	<u>820,383</u>	<u>946,654</u>
WORKING CAPITAL AT END OF YEAR	<u><u>\$769,312</u></u>	<u><u>\$820,383</u></u>

Claiborne Industries Limited

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED SEPTEMBER 30, 1977

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of consolidation

The consolidated financial statements include the accounts of the company and its subsidiaries all of which are wholly-owned.

(b) Advances (see note 3)

(c) Fixed assets

Depreciation is provided on a straight-line basis using the following annual rates:

Building	—	5%
Equipment	—	10%
Automotive	—	25% the first year and 20% thereafter

(d) Debenture discount

Debenture discount is amortized to income on a straight-line basis over the terms of the applicable issue.

(e) Earnings per share

Earnings per share have been calculated on the basis of the weighted average number of shares outstanding during the period.

2. ACCOUNTS RECEIVABLE

The company has placed a major customer in receivership and is proceeding to enforce its security against the customer and against the personal guarantees provided by its shareholders. The company has made full provision for loss in respect of the account (\$225,000 in 1977, \$200,000 in 1975 and \$50,000 in 1974 for a total of \$475,000), since it does not appear any amounts will be recovered.

The allowance for doubtful accounts in respect of other trade receivables amounted to \$209,172; \$183,909 at September 30, 1976.

3. ADVANCES

On January 16, 1978, the company commenced legal action against former shareholders and companies related to them, the companies' bankers and others which, among other things, seeks recovery of the following:

- (i) Advances in the principal amount of \$1,106,252;
- (ii) An interest component, being an amount equal to the interest charges incurred by the company with respect to monies borrowed to finance the Advances, or in the alternative, interest at 15% on the Advances. Under the latter approach, this amount would approximate \$540,000 to September 30, 1977;
- (iii) Non-recurring corporate expenses incurred in connection with the Advances;
- (iv) General and other damages.

The company on advice of legal counsel considers that the Advances as made constituted a fraudulent transfer of funds and that the interest reflected in previous financial statements (both that capitalized in the promissory notes securing the Advances with effect as of January 31, 1976 and that accrued subsequently) would not necessarily be recoverable as such but would be, potentially, a component of any damage award. Accordingly the company has changed its accounting policy; no interest has been accrued in the current year, the prior years' financial statements have been restated to eliminate interest on the Advances and all recoveries on the liquidation of security have been credited to principal.

If the legal action is unsuccessful, the company's recovery of the Advances of \$1,106,252 may be limited to realizations available from the following security, the status of which as at December 31, 1977 is summarized as follows:

(i) Finch and Weston Road Property

The company has a \$379,879 interest in a 10% first mortgage maturing July 8, 1979. The total amount of the mortgage is \$755,500, subject to a prior interest in the mortgage of \$375,621. On realization, the amounts recovered will be applied firstly, against advances of \$129,583 made with respect to prior

obligations on the property and secondly, in reduction of the principal amount of the Advances which are the subject of the legal action described above.

(ii) Chattel Mortgage on Livestock

During the year certain of the livestock, which are the subject of the chattel mortgage, were disposed of by a bank holding other security interests in the livestock. The company has realized \$495,000 from the sale and the bank has agreed to pay the company an additional \$99,000 from further sales (\$31,600 received subsequent to September 30, 1977). The company on advice of legal counsel has taken the position that it is entitled to approximately \$300,000 from such further sales.

(iii) Marina Mortgages

The company holds a mortgage of leasehold on a marina property in the amount of \$300,000. The operations of the marina, pursuant to an order dated January 3, 1978 are in the control of an interim receiver.

(iv) Burlington Square

Results of litigation and other factors would indicate that there exists little likelihood of any recovery from the company's 80.8% interest in 50% of the \$2.5 million mortgage on the Burlington Square property (see note 7).

4. FIXED ASSETS

			1977	1976
	Cost	Accumulated depreciation	Net	Net
Land	\$150,796		\$150,796	\$150,796
Building	529,264	\$258,741	270,523	289,109
Equipment	99,105	92,390	6,715	7,158
Automotive	77,886	58,469	19,417	25,083
	<u>\$857,051</u>	<u>\$409,600</u>	<u>\$447,451</u>	<u>\$472,146</u>

5. OTHER ASSETS

	1977	1976
Debenture discount	\$ 3,456	\$ 5,506
Investment in Creative Patents & Products Limited	1	1
Other (see note 7)		10,000
	<u>\$ 3,457</u>	<u>\$15,507</u>

6. BANK INDEBTEDNESS

	1977	1976
Cheques issued in excess of amounts on deposit	\$ 32,111	\$ 181,704
Demand bank loans	1,079,507	1,308,500
	<u>\$1,111,618</u>	<u>\$1,490,204</u>

A demand loan of \$975,000 is secured by a general assignment of book debts, a collateral mortgage on the company's building, the assignment of the company's interest in the sale of the Finch and Weston Road property and a floating charge debenture of \$1,500,000 on all assets of the company. A subsidiary's demand loan in the amount of \$104,507 is secured by a Series B debenture of the company of \$135,000.

The company's bankers have provided guarantees of \$325,000 to certain of the company's suppliers.

7. LONG TERM DEBT

	1977	1976
The company		
Series B debentures, 9½%, maturing April 1, 1979, convertible into common shares at \$2.75 per share, secured by a first floating charge* on all assets of the company (see note 10)	\$ 550,000	\$ 685,000
Other	6,094	9,543
Subsidiary, Rocamora Corporation Limited		
10½% Mortgage, due June 1, 1980, amortized over twenty-five years	336,559	342,916
15% Mortgage, due November 1, 1978, amortized over twenty-five years . . .	147,327	148,872
Series A debentures, 11%, maturing January 13, 1981, secured by a first floating charge* on all assets of the subsidiary	300,000	320,000
Other		6,550
	<u>1,339,980</u>	<u>1,512,881</u>
Included in current liabilities	12,310	14,527
	<u>\$1,327,670</u>	<u>\$1,498,354</u>

**Subject to prior charge securing bank indebtedness.*

The company

By supplemental indenture, the maturity date of the Series B debentures has been extended from April 1, 1977 to April 1, 1979. \$795,000 of these debentures are issued and outstanding, \$245,000 of which are held by subsidiaries.

Subsidiary

- (i) The accounts reflect \$225,000 of outstanding debentures issued in 1976 in exchange for Claiborne debentures in the amount of \$210,000. The documents relating to the exchange reflect agreement to issue \$235,000 of these debentures. The holder claims not to have agreed to this exchange and it may be that a claim will be asserted to re-establish the original Claiborne debentures.

Interest has been provided in the accounts at 11% on \$225,000 and payments on account of interest have been made.

- (ii) Certain of the subsidiary's debentures are the subject of litigation (see note 11(ii)). The amounts in question have been accounted for as follows:

- Debentures of \$100,000 were issued to a former director and shareholder and companies related to them for an inadequate consideration (a further \$100,000 interest in the Burlington mortgage referred to in note 3). Accordingly, the transaction has been reversed.
- A debenture of \$10,000 was issued in 1976 for an inadequate consideration (an investment included in other assets). Accordingly, the transaction has been reversed.
- Debentures of \$35,000 are included in long term debt above although the holders of such debentures are indebted to the company for a greater amount and the company on advice of legal counsel believes that a right of set-off exists.
- Unpaid interest on these debentures in the amount of \$5,757 to September 30, 1977 has not been recorded in the accounts.

While the subsidiary's debentures are in technical default, they have been included in long term debt or reversed as reflected above on the basis that the resolution of the matters referred to will not require the use of existing resources.

Principal payments on long term debt, based on the maturity dates reflected in the table above, for each of the three years subsequent to September 30, 1978 are as follows:

1979	—	\$ 700,217
1980	—	327,453
1981	—	300,000
		<u>\$1,327,670</u>

8. CAPITAL STOCK

The common shares may be converted at any time into fully paid Class A shares on the basis of one common share for each Class A share, provided that no more than 90% of the common shares issued and outstanding as fully paid shall be so converted into Class A shares.

The company has reserved 200,000 common shares for conversion of the Series B debentures to April 1, 1979. In addition, an employee holds an option to acquire 10,000 shares at \$1.83 per share, expiring July 14, 1979.

9. INCOME TAXES

At September 30, 1977 the companies have losses available, subject to assessment by taxation authorities, to reduce future years' income for tax purposes, the tax effect of which has not been recorded in the accounts, as follows:

Expiring:		
1978	—	\$ 87,100
1979	—	42,000
1980	—	45,800
1981	—	75,700
1982	—	260,000
		<u>\$510,600</u>

In addition, the undepreciated capital cost of the assets for income tax purposes exceeds their net book value by \$110,000.

10. ACQUISITION OF SUBSIDIARY

Effective December 31, 1976, a subsidiary acquired all of the outstanding shares of Braywood Corporation Limited for consideration of \$833. The values assigned were as follows:

Series B debenture of the company (book value \$135,000)	\$123,894
Bank indebtedness secured by the debenture	(105,088)
Current liabilities assumed	(17,973)
Net assets acquired	<u>\$ 833</u>

11. LEGAL PROCEEDINGS

- (i) The company, on January 16, 1978, commenced a legal action, the details of which are described in note 3.
- (ii) The holders of \$145,000 of the outstanding Series A debentures of the subsidiary (see note 7) have commenced a legal action seeking payment of unpaid interest, return of the principal amount of the debentures and costs, as well as claiming possession of the assets of that subsidiary. The company on advice of legal counsel believes that the subsidiary has a good defence to the action.
- (iii) Criminal charges alleging that former officers and directors of the company did unlawfully conspire together and with others to defraud the company and its subsidiaries have been the subject of a preliminary hearing which has not yet been concluded.

12. OTHER INFORMATION

- (i) Remuneration of directors and officers was as follows:

Directors and officers prior to June 17, 1977	\$171,000
Directors and officers subsequent to June 17, 1977	51,000
Total (1976 — \$158,000)	<u>\$222,000</u>

- (ii) An amount of \$21,000 was paid to the professional firm of an officer of the company as fees for legal services rendered prior to June 17, 1977. Amounts of \$32,000 and \$24,000 were paid or accrued to professional firms of an officer and a director, as fees for legal and accounting services respectively for services rendered to September 30, 1977.

